

ATTACHMENT 3

METHODOLOGY FOR SETTING THE DISCOUNT RATE FOR LOCAL AGENCIES TERMINATING THEIR CONTRACT FOR RETIREMENT BENEFITS AND FOR THE TERMINATED AGENCY POOL

The Chief Actuary will set the discount rate assumption to be used for actuarial valuations for employers terminating their contract with CalPERS and leaving their assets and liabilities in the terminated agency pool and for the annual actuarial valuation of the Terminated Agency Pool. The discount rate will be set by taking into account the yields available in the US Treasury market on the date of the termination of contract and on June 30 each year for the annual valuation of the Terminated Agency Pool according to the methodology described below.

The Chief Actuary will first determine the duration of the pension liabilities of the terminating agency at the date of termination or in the case of the Terminated Agency Pool on June 30th of each year. Next, the Chief Actuary will determine the weight that should be applied to the 10 and 30 year US Treasury durations, determined at current spot rates, to equal the duration of the termination liabilities. The discount rate assumption will be calculated by using the weighted percentages from the duration calculation and applied to the 10 and 30 year US Treasury yields to determine the discount rate assumption.

For example, the duration of the liabilities for the Terminated Agency Pool is 12. On June 30, 2011, the duration of the 10 year and 30 US Treasury securities were 8.3 and 15.6 respectively. A 50% weighting of 10 year and 30 year Treasury security durations are calculated to be 12 which equals the liabilities duration. Therefore, the discount rate assumption used for valuing the liabilities will be 50% of the 10 year US Treasury yield and 50% of the 30 year US Treasury yield. The 10 year US Treasury yield was 3.18% on June 30, 2011 while the 30 year US Treasury yield was 4.38% on June 30, 2011. A 50%/50% weighted average of both rates would result in a discount rate assumption of 3.8% for the valuation of the terminated agency pool as of June 30, 2011.